FILED
NOV 24 1942
CHARLES ELMORE CROPLEY
CLERK

21

Supreme Court of the United States

OCTOBER TERM—1942

No. 542

ADDISON S. PRATT, as Trustee of JACELLEN REALTY CORPORATION, Debtor,
Petitioner, (Plaintiff below),

against

CHEMICAL BANK & TRUST COMPANY and THE CONTINENTAL BANK AND TRUST COMPANY OF NEW YORK,
Respondents, (Defendants below).

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

ADDISON S. PRATT,
Petitioner in person,
21 West Street,
New York City,

INDEX OF PETITION

	PAGE
Jurisdiction	1
Opinions Below	2
Matters Involved, Statement of	2
Questions Presented	3
Statutes Involved	4
§15 New York Stock Corporation Law	4
§70(e) Bankruptcy Act	5
Errors, Specification of	5
Reasons for Issuance of Writ	6

Index of Brief

Argument as to First Causes of Action	12
Necessary Elements	12
Insolvency of Debtor, if not existent, was imminent	12
The Setoffs resulted in preferences	14
Knowledge of Banks that the setoffs would result in preferences	15
Debtor intended to prefer	15
Argument as to Second Causes of Action	19
Debtor had failed to pay its obligations, when due	19
Banks were stockholders of Debtor	20
Facts, Statement of	9
Conclusion	21

Authorities Cited

	PAGE
Almond-Jones Co., Inc., In Re, 13 Fed. (2d) 152	18
Barker v. *472 Fulton Street Corp.,* 24 N. Y. Supp. (2d) 570, 262 App. Div. 892	19
Childs v. *County Trust Co. of N. Y.,* 6 Fed. Supp. 821, 70 Fed. (2d) 1012	12
Citizen's National Bank of Gastonia, N. C. v. *Lineberger,* 45 Fed. (2d) 522	18
Frankford Trust Co. v. *Comber,* 68 Fed. (2d) 471, 5 Fed. Supp. 659	18
German-American State Bank v. *Larimer,* 235 Fed. 501	18
Irving Trust Co. v. *Chase National Bank of the City of New York,* 72 Fed. (2d) 668	12
Kentucky Rock Asphalt Co. v. *Helburn,* 108 Fed. (2d) 779	18
Kolkman v. *Manufacturers Trust Co.,* 27 Fed. (2d) 659	17
Lee v. *Riefler & Sons, Inc.,* 43 Fed. (2d) 364	21
Malcolm v. *Allen,* 49 N. Y. 448	19
Matters v. *Manufacturers Trust Co.,* 54 Fed. (2d) 1010	17
National Bank v. *Case,* 99 U. S. 628	21
N. Y. County National Bank v. *Massey,* 192 U. S. 138	7
Palmer Clay Co. v. *Brown,* 297 U. S. 227	15
Poole v. *West Point Butter & Cheese Association,* 30 Fed. 513	21
Rosevelt v. *Brown,* 11 N. Y. 148	21
Union Trust Co. v. *Peck,* 16 Fed. (2d) 986	18
Van Tuyl v. *Robin,* 160 App. Div. 41, 211 N. Y. 540	21
Willcox v. *Goess,* 16 Fed. Supp. 350, 92 Fed. (2d) 8	12
Wil-Low Cafeterias, Inc., In Re, 22 Fed. Supp. 617, 95 Fed. (2d) 306	14

Supreme Court of the United States

OCTOBER TERM—1942

ADDISON S. PRATT, as Trustee of JACELLEN REALTY CORPORATION, Debtor,
Petitioner, (Plaintiff below),

against

CHEMICAL BANK & TRUST COMPANY and THE CONTINENTAL BANK AND TRUST COMPANY OF NEW YORK,
Respondents, (Defendants below).

No.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

TO THE SUPREME COURT OF THE UNITED STATES:

Addison S. Pratt, as Trustee of Jacellen Realty Corporation, Debtor, respectfully prays this Honorable Court for the issuance of a Writ of Certiorari to review the judgment of the United States Circuit Court of Appeals for the Second Circuit in the above entitled action.

Jurisdiction

The jurisdiction of this Court is based on §240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

The judgment of the Circuit Court of Appeals, sought to be reviewed, was entered on August 19, 1942.

This petition was filed on November 24, 1942, the time to file the same having been extended, by order of Mr. Justice Jackson, to that date.

Opinions Below

The opinion of the Circuit Court of Appeals is reported in 129 Fed. (2d) 1016. The opinion of the District Court has not been officially reported.

Statement of Matters Involved

The action was brought by the Trustee of the Debtor, appointed in proceedings for its reorganization under §77B of the Bankruptcy Act, to recover from the defendants, Chemical Bank & Trust Company and The Continental Bank and Trust Company of New York, the sums of $17,332.26 and $27,327.41, respectively, as constituting transfers, admittedly made in payment of antecedent indebtedness, and alleged to be voidable by the Trustee under Section 70(e) of the Bankruptcy Act, on two grounds:—

(1) that they had been made at a time when the Debtor was insolvent, or its insolvency was imminent, and with the intent of giving the Banks a preference over other creditors, as they knew, or had reasonable cause to believe, in violation of the second sentence of Section 15 of the New York Stock Corporation Law, and (2) that they had been made at a time when the Debtor had refused to pay its obligations, when due, the Banks being stockholders of the Debtor, in violation of the first sentence of Section 15.

The sums so transferred were the balances in the deposit accounts of the Debtor with the Banks on October 19, 1937 when the Banks set off these balances against the Debtor's demand notes.

Third causes of action under Sections 60(a) and (b) of the Bankruptcy Act were also alleged but were abandoned on the trial.

The complaint, as to both causes of action against each Bank, was dismissed by the trial court and its judgment was affirmed, but on different grounds, by the Circuit Court of Appeals.

The evidence was neither contradicted nor contradictory. Decision depends upon the conclusions or inferences to be drawn from the evidence—questions of law. As to the first causes of action, the trial court held (R. 29-31) that it could not be inferred that insolvency of the Debtor was either actual or imminent or that there was an intent to prefer the Banks when the deposits in the accounts were made or on October 19, 1937. The Circuit Court of Appeals (R. 365-366) did not consider insolvency but held that there was no intent to prefer and that the transfers could be upheld as banker's liens entitled to setoff.

As to the second causes of action, the trial court held (R. 31-32) that the Debtor had not failed to pay its obligations, when due, but did not consider whether the Banks were stockholders. The Circuit Court of Appeals, on the other hand, held (R. 366) that the Banks were not stockholders but did not pass upon the other question.

Questions Presented

1. Under the circumstances here present, were the defendant Banks entitled to set off the balances in the Debtor's deposit accounts against the Debtor's demand notes, when such deposits had been made so that the Banks might seize them at any time and could be withdrawn by the Debtor only with the consent of a representative of the Banks, or did such deposits and such subsequent application of the balances constitute preferential transfers under the second sentence of §15 of the New York Stock Corporation Law, voidable under §70(e) of the Bankruptcy Act by the Debtor's trustee appointed under §77B of the Bankruptcy Act?

2. Did the application by the defendant Banks on account of the Debtor's demand notes of the balances in the

Debtor's deposit accounts, the Banks having required, as a condition of making the loans, that all the Debtor's capital stock be transferred to their nominees, and having refused to allow the Debtor to use the balances to pay the interest on its mortgage, constitute a transfer of the Debtor's property to its stockholders for the payment of a debt, prohibited by the first sentence of Section 15 of the New York Stock Corporation Law and voidable, under Section 70(e) of the Bankruptcy Act, by the Debtor's trustee?

The Statutes Involved

The first sentence of Section 15 of the New York Stock Corporation Law provides:

> "No corporation which shall have refused to pay any of its notes or other obligations, when due, in lawful money of the United States, nor any of its officers or directors, shall transfer any of its property to any of its officers, directors or stockholders, directly or indirectly, for the payment of any debt, or upon any other consideration than the full value of the property paid in cash.

The second sentence of Section 15 of the New York Stock Corporation Law provides:

> "No conveyance, assignment or transfer of any property of any such corporation by it or by any officer, director or stockholder thereof, nor any payment made, judgment suffered, lien created or security given by it or by any officer, director or stockholder when the corporation is insolvent or its insolvency is imminent, with the intent of giving a preference to any particular creditor over other creditors of the corporation, shall be valid, except as to any rights or interests which may be acquired thereunder by any person without notice or reasonable cause to believe that such conveyance, assignment, transfer, payment, judgment, lien or security would effect a preference. * * *

"Every person receiving by means of any such prohibited act or deed any property of a corporation shall be bound to account therefor to its creditors or stockholders or other trustees. * * * Every transfer or assignment or other act done in violation of the foregoing provisions of this section shall be void, except as hereinbefore provided."

Section 70(e) of the Bankruptcy Act provides:

"e. (1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor.

"(2) All property of the debtor affected by any such transfer shall be and remain a part of his assets and estate, discharged and released from such transfer and shall pass to, and every such transfer or obligation shall be avoided by, the trustee for the benefit of the estate. The trustee shall reclaim and recover such property or collect its value from and avoid such transfer or obligation against whomsoever may hold or have received it, except a person as to whom the transfer or obligation specified in paragraph (1) of this subdivision e is valid under applicable Federal or State laws."

Specification of Errors

The Circuit Court of Appeals erred in

(1) dismissing the complaint,

(2) holding that the Debtor had no intent to prefer the Banks and that the Banks, in the exercise of their banker's liens, had the right to set off the balances in the Debtor's accounts, and

(3) holding that the Banks were not stockholders of the Debtor.

The District Court also erred in

(1) dismissing the complaint,

(2) holding that insolvency of the Debtor was neither actual nor imminent,

(3) holding that the Debtor did not intend to prefer the Banks, and

(4) holding that the Debtor had not failed to pay its obligations, when due.

Reasons for Issuance of Writ

The first question is one of general public interest and great importance in the administration of the Bankruptcy Act, for, if the decision of the Circuit Court of Appeals is sound, a way is approved whereby a bank may lend money to its depositor on the latter's demand note and, by demanding and obtaining absolute and complete control of its depositor through transfer to a nominee of all its capital stock, control of its board of directors and control over its operations by requiring that all its income be deposited with it and withdrawn only upon the counter-signature of its appointee on all checks, may, when the depositor has become insolvent, or its insolvency has become imminent, set off against the note the balance in the account in the exercise of its banker's lien, despite the fact that all the deposits had been made with the intention of creating a fund which the bank might apply in setoff whenever it might choose to do so.

Here, as a result of these setoffs, Chemical received about 93% of the Debtor's indebtedness to it and Continental about 46%, while the first mortgagee and the holders of the participation certificates issued thereunder received nothing at all on account of the interest which was due to them eighteen days before the setoffs. The Debtor was denuded of all its assets except its real estate, and was obliged to give an assignment of the rents to the mortgagee.

The decision below seems clearly erroneous and directly contrary to the qualifications upon the right of a bank to set off a balance in its depositor's account against the latter's note which this court stated in the case of *N. Y. County National Bank* v. *Massey*, 192 U. S. 138.

It was there held that the balance in a regular bank account at the time of adjudication is a debt due from the bank to the bankrupt and that, *in the absence of fraud or collusion between the bank and the bankrupt with the view of creating a preferential transfer*, the bank need not surrender the balance but may set it off against notes of the bankrupt held by it, on the theory that a deposit of money to one's credit in a bank does not operate to diminish the estate of the depositor, for, when he parts with the money he creates at the same time, on the part of the bank, an obligation to pay the amount of the deposit whenever he may see fit to draw a check against it.

In the case at bar, the Circuit Court of Appeals held that the deposits in the Debtor's account had not been made for the purpose of giving a preference to the Banks, despite uncontradicted evidence that that was the original arrangement when the loans were first made in March, 1934, the reasoning leading to this conclusion being that such an intent could not be sustained through the vicissitudes of three years' business dealings, because the Debtor knew that its accounts might be debited at any moment, which was not the same as saying that the money was deposited so that it would be debited (R. 365). The court entirely overlooked the element of absolute control which the Banks had over the Debtor and which continued during the entire three year period. It is this fact and the fact of collusion or agreement between the Debtor and the Banks that all the Debtor's income—the rents from its property—should be deposited with them where it would be available for setoff whenever the Banks might desire, which brings this case within the exception in the *Massey* case. This justifies the issuance of a writ of certiorari to review the first question in order to prevent the course of action here from being followed as a precedent by other banks.

As to the second question, the decision of the Circuit Court of Appeals that the Banks were not stockholders of the Debtor but only creditors, holding the stock as security merely, seems clearly erroneous, for pledgees of stock held as collateral are deemed to be stockholders where the stock has been transferred into the pledgee's name. Whether they are to be treated as stockholders under §15 of the New York Stock Corporation Law has never been considered in any reported case, State or Federal. This question should be reviewed in connection with the first question, for it is so closely connected with the first question as to be collateral thereto.

The decision of the District Court (the question was referred to only in passing by the Circuit Court of Appeals) that the Debtor had not refused to pay its obligations, when due, also should be reviewed as part of this question. It, too, seems clearly erroneous, for the reason that it was based solely on the fact that the Debtor had never paid the interest on its mortgage punctually on the due date and the conclusion therefrom that the due date had thereby been extended—a conclusion incompatible with an express covenant of the mortgage.

For the reasons aforesaid the issuance of a Writ of Certiorari is sought.

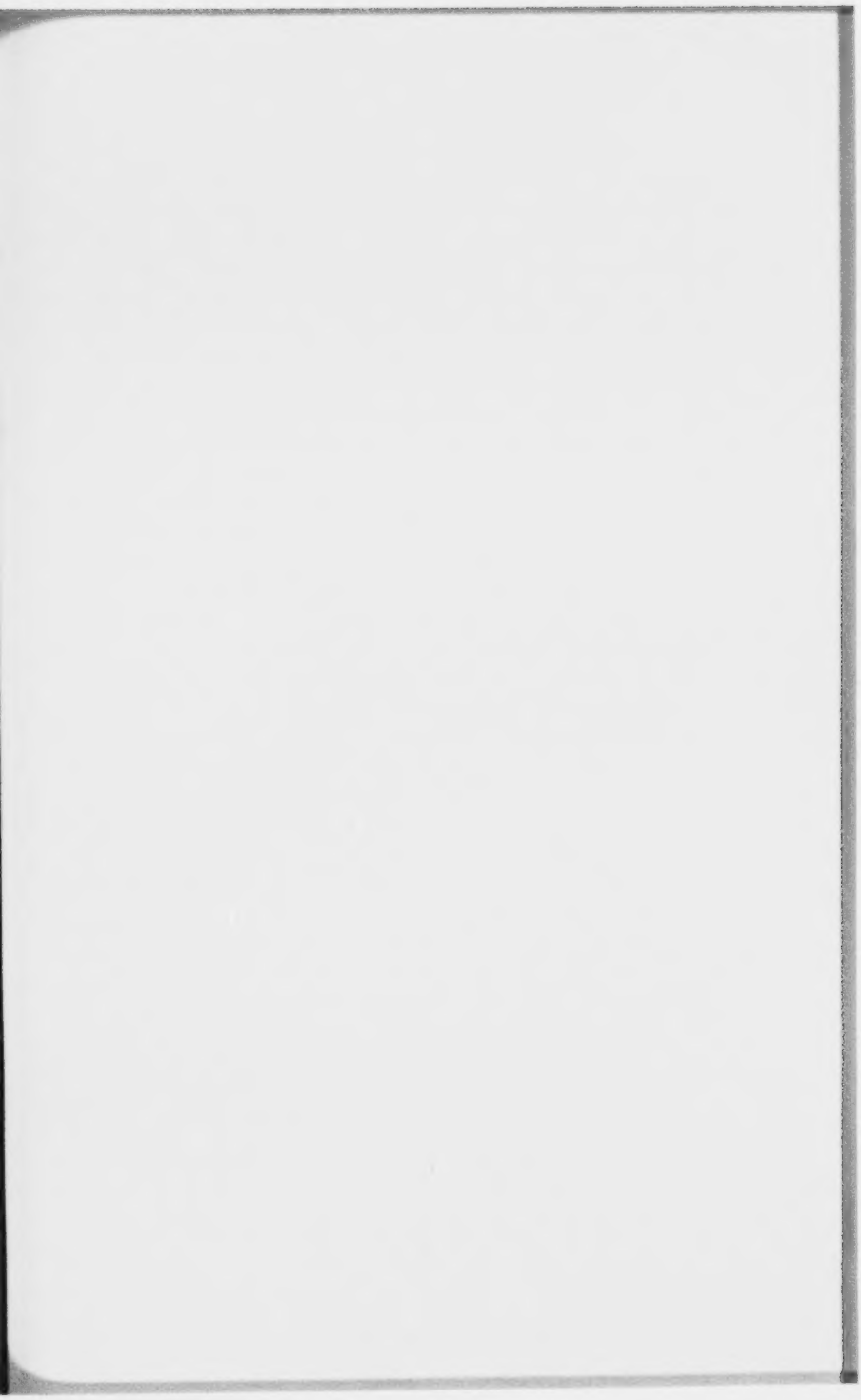
Dated, November 23, 1942.

Respectfully Submitted,

ADDISON S. PRATT,
Petitioner in person,
21 West Street,
New York City.

I hereby certify, as a member of the bar of this Court, that the foregoing petition is, in my opinion, well founded and that it is not submitted for purposes of delay.

ADDISON S. PRATT,
Petitioner in Person.



BRIEF IN SUPPORT OF PETITION

The Facts

The salient facts are the following. Others are referred to in the opinion of the District Court (R. 18-27).

The Debtor's sole asset was a large apartment house in New York City, subject to a first mortgage of $1,474,250, which fell due on October 1, 1937 (Ex. 3, R. 175, Ex. 4, R. 195, 202) and in which the mortgagee had issued certificates of participation in the amount of $1,325,000 (R. 322).

In March, 1934 it applied to the Banks for a loan of $54,000 in order to permit it to settle the unpaid claims of material men secured by a second mortgage on the property (R. 46). The Banks at the time were interested in the Debtor's affairs, Continental holding its unsecured note for $44,500 (R. 323), and Chemical holding, as trustee for both, some of the Debtor's capital stock under a deed of trust from Campbell, Debtor's former president, who had died, insolvent, in April, 1933 (R. 323), giving it full power of disposition over the stock, all dividends and proceeds of sale to be applied on account of Campbell's obligations to both Banks (Ex. 21, 338-344).

Each bank agreed to make a loan of $27,000 on the Debtor's collateral demand note, the collateral recited in the notes (which were identical) being the second bond and mortgage (not considered as having any value), and all stocks held by the Bank for the Debtor's benefit, cash and deposit balances held at any time (Ex. 2, 168-169). The notes authorized the Banks to apply the balance in any deposit account to any liabilities of the Debtor.

The Debtor's president, Ellinger, who applied for the loans, the officers of the Banks, Edwards of Chemical and Hasler and Gurock of Continental, and the lawyers who represented the Banks in the matter, Crouse and Gettinger,

all testified that the loans were made upon, and only upon, the liquid security of the rents, not actually assigned but to be pledged as collateral as they were deposited in accounts "which the Banks would control," and accumulating every six months (April and October, when both the semi-annual interest of $44,227.50 on the first mortgage and the semi-annual real estate taxes, about $21,000, would become due), so that, as Hasler testified, "there would be built up every six months an amount that could be used for offset purposes," and, as Edwards testified, he "relied on our right to resort to the cash balance," as the Debtor had no other asset on which to raise cash. (Ellinger, R. 46, 67-68, Hasler, R. 135-136, 138-139, Edwards, R. 128-129, 134, Gurock, R. 140-141, Crouse, R. 146-148, Gettinger, R. 102, 105-107, 108-110).

The Debtor also agreed to execute a formal assignment of the rents, whenever requested, but it was never requested, because it would involve a lot of bookkeeping (R. 109) and also, doubtless, because the first mortgage provided that the principal should become due, at the option of the mortgagee, if an assignment of the rents should be given without its written consent (Ex. 3, R. 178).

To secure and maintain at all times control over the rents, for they were not turned over so as to become the property of the Banks but were deposited in accounts in the Debtor's name, the Banks required four things, which were done, viz:—(1) that all the capital stock of the Debtor, having voting power, be transferred into the names of their nominees, (2) that there be a board of four directors, two to be nominated by the Banks, (3) that the managing agent deposit all rents collected, directly in accounts in the two Banks in the name of the Debtor, without depositing them in any interim account, and (4) that no withdrawals from these accounts be permitted except upon checks countersigned by one of the two directors nominated by the Banks (R. 326-327).

Each April and October, beginning with October, 1934, the Banks conferred for the purpose of determining whether

to apply the balances in the accounts to their notes or to continue the loans and release the moneys to pay interest and taxes (R. 329-330). Each time, until October, 1937, they decided on the latter course, notwithstanding that, beginning with October, 1935, the balances were never sufficient to pay interest and taxes, so that the Banks had to make temporary loans for the purpose, which continually increased, from $5,000 in October, 1935, to $16,800 in April, 1937 (R. 331-332).

Expenses of operation and maintenance were always paid as they accrued (R. 331).

On October 1st, 1937, when the principal of the first mortgage fell due, foreclosure was authorized under the New York Moratorium Law, if either interest or taxes should not be paid. The Banks decided at their usual conference, over the protest of the Debtor's president, not to advance any money to permit payment of interest and taxes and, although the balances were sufficient to pay the interest, they set off on October 19th against the Debtor's notes the entire balances in the accounts, Chemical thus applying $17,332.26 to the balance of $18,641 due it and Continental applying $27,327.41 to the balance of $59,702.03 due it (R. 62, 119, 331).

Immediately upon hearing of this action the first mortgagee demanded and obtained, under threat of foreclosure, an assignment of the rents to which the Banks consented at the foot (R. 93, 120). The first mortgagee thus took over the management of the Debtor's only asset, its apartment house, and, though the Debtor remained alive, it no longer had control over its property or conducted its business in the usual manner.

Within three months, viz. on January 5th, 1938, the Debtor's directors, the two nominated by the Banks being present, resolved to file a petition for its reorganization under § 77B on the ground that it was unable to pay its debts as they matured and such a petition, containing the same admission, was filed and approved on January 8th (Ex. 4, R. 183-213).

Argument as to First Causes of Action

Necessary Elements

The four elements necessary for recovery under the first causes of action are

(1) that insolvency of the bankrupt (Debtor) existed, or was imminent, at the time of the alleged preferential transfer,

(2) that the transfer resulted in a preference,

(3) that the transferee knew, or had reasonable cause to believe, at the time of the transfer, that it would result in a preference, and

(4) that the bankrupt (Debtor) intended to give a preference.

Irving Trust Co. v. *Chase National Bank of the City of New York,* 72 Fed. (2d) 668 (C. C. A. 2).

Insolvency of the Debtor, if Not Existent, Was Imminent

The word "insolvency", as used in Section 15 of the New York Stock Corporation Law, means inability to meet one's obligations as they mature, and not an excess of liabilities over assets.

> *Childs* v. *County Trust Co. of New York,* 6 Fed. Supp. 821, 823, affirmed without opinion in 70 Fed. (2d) 1012 (C. C. A. 2).

Or, as Woolsey, J. expressed it, inability as a going concern, having regard to the amount and maturities of its obligations and the amount and nature of its assets, to realize on its assets so as to meet its obligations as they fall due.

> *Willcox* v. *Goess,* 16 Fed. Supp. 350, affirmed on this point in 92 Fed. (2d) 8 (C. C. A. 2).

Here, the Debtor's only assets on October 19, 1937 were (1) the balances, $44,659.27, in its deposit accounts in the Banks, (2) its apartment house, subject to an overdue first mortgage of $1,474,250, and (3) current rentals of about $2,900 (Ex. 17, R. 318). (The leases were hardly a saleable asset.) The schedule of assets annexed to its petition for reorganization lists rentals due from tenants of apartments vacated, etc. of approximately $23,000, but they were probably largely uncollectible.

The Debtor's obligations on that day were (1) $1,474,250, principal, and $44,227.50, interest, on its first mortgage, both of which had fallen due on October 1st, (2) real estate taxes, approximately $21,000, payable that month, without penalty, (3) $78,638.34 due the two Banks on its demand notes, (4) notes for $24,130, with accrued interest of approximately $6,000, held by the Aeson Corporation, secured by a junior interest in the second mortgage (Ex. 4, R. 204, 212), and (5) about $2,700 of operating and maintenance bills (Ex. 17, R. 318), subsequently paid from the current rentals of $2,900.

The net income, before interest, from the apartment house had steadily fallen from $120,832.86 for 1934 to $92,411.68 for the 12 months ending September 30, 1937 (R. 150). For two years it had had to borrow, every April and October, increasing amounts in order to pay interest and taxes.

The Circuit Court of Appeals did not consider the question of insolvency but the trial court held that, because from May to October, 1937, it had been able to meet its obligations, as they matured, it was not insolvent on October 19th, nor was insolvency imminent (R. 30). But the only obligations which it had to meet during this period were the expenses of operating and maintaining its apartment house. The trial court entirely overlooked the interest and taxes due in October, to meet which it had to accumulate funds, and the fact that the amounts accumulated were approximately $21,000 short.

On either test, inability to meet its obligations as they matured or inability to realize on its assets so as to meet its obligations as they fell due, the Debtor was insolvent on October 19th. In fact, its insolvency had been imminent, if not actual, at least since April, 1937, when the Banks, in order to avoid a default on the mortgage and consequent foreclosure which would have wiped out their equity, had had to make a temporary loan of $16,800 to the Debtor to enable it to pay interest and taxes. Indeed, it might be argued that it had been insolvent ever since October, 1935, when the Banks had first been obliged to lend it $5,000 to pay interest and taxes.

Furthermore, the Debtor admitted its insolvency when, in its petition for reorganization, it stated, as required by §77B(a), that "Debtor is unable to pay its debts as they mature" (Ex. 4, R. 207). This has been held to constitute an admission of insolvency in the sense used in the second sentence of §15.

In Re Wil-low Cafeterias, Inc., 22 Fed. Supp. 617, 619, reversed, but on other grounds, in 95 Fed. (2d) 306 (C. C. A. 2).

The Setoffs Resulted in Preferences

Whether these setoffs resulted in the Banks' obtaining a greater portion of their claims was not considered by either of the lower courts. The evidence, however, showed conclusively that this was the result.

On October 19th, 1937, the Debtor owed $44,227.50, interest on its first mortgage. The holders of the certificates of participation in the mortgage never received any of this interest. Payments on account of interest were made during the pendency of the reorganization proceedings but, when the plan of reorganization was approved on November 14, 1939, the unpaid interest amounted to $82,567.17, $1,556,817.17 less $1,474,250 (Ex. 13, R. 280), an increase

of $38,339.67 over the amount due on October 19th. Chemical had received $17,332.26 on account of the balance of $18,641.00 due it and Continental $27,327.41 on account of the balance of $59,702.03 due it.

As the court also found (R. 280) that the fair value of the premises was only $1,400,000, the difference of $156,817.17 constituted a general claim upon which likewise nothing was paid. Also, notes for $24,130 held by Aeson Holding Corporation, secured by a junior interest in the second mortgage were wiped out (R. 278, 281).

The test is the actual result when the estate is liquidated and distributed, either in bankruptcy or reorganization.

Palmer Clay Co. v. *Brown*, 297 U. S. 227, 229.

Knowledge of the Banks that the Setoffs Would Result in Preferences

That the Banks knew that the setoffs would result in preferences to them follows from their knowledge of the Debtor's financial situation and that application of the balances in the accounts would leave nothing with which to pay the overdue interest and taxes.

The Debtor Intended to Give the Banks Preferences

The Circuit Court of Appeals held that there was no intent to prefer, for it was "obvious that the rents deposited prior to October 18 were not specifically for the purpose of effecting a preference to the Banks," that "the only way an intended preference can be worked out is to rely on the original agreement entered into in 1934," but that "it is not possible to sustain an intent through the vicissitudes of three years of business dealings," because "the debtor knew that its accounts might be debited at any moment," which "is not the same as saying that money

was deposited so that it would be debited." (R. 365), and that, therefore, the usual banker's lien rule applied.

This conclusion that there was no intent to prefer rests upon the supposed abrogation of an agreement which, the court admitted, was made in 1934. The testimony that there was such an agreement, referred to at pages 9-10, *supra*, was unanimously to the effect that, when the loans were made, it was understood that a fund would be built up, every April and October, to which the Banks could resort for offset purposes, that the loans would not have been made otherwise and that the deposits in this fund were not subject to free disposition by the Debtor because the Banks controlled the right of withdrawal at all times.

A year later, when Longua, representing the junior interest in the first mortgage, sought a modification of the mortgage so as to provide for more frequent interest payments or deposits, monthly, bi-monthly or quarterly, so as to be relieved of his semi-annual worry as to whether interest and taxes were going to be paid, the Banks refused to make any change, saying that they wanted their loans to remain liquid, "so that twice a year they would have the maximum amount on hand * * * so they would be in a position to liquidate to the greatest extent, in full, or at least partially, the amount of the loan" (R. 90-92). Though all the Banks' officers testified after Longua, none of them contradicted his testimony.

There is no evidence whatever that this original understanding or agreement was ever at any time modified or terminated. In fact, the Banks stipulated that every April and October they conferred "for the purpose of determining whether or not they would apply the amounts on deposit * * * or would continue said notes and release the funds to pay taxes and interest" (R. 329-330).

Why it is "not possible to sustain an intent through the vicissitudes of three years of business dealings" is not at all clear. The Circuit Court of Appeals gave no reason for its assertion. And the rule has always been that a

situation or agreement once shown to exist is presumed to have continued until the contrary has been shown or until facts have been adduced from which it may be fairly inferred that the situation or agreement has been changed. No such evidence, however, was here produced. In fact, the situation remained unchanged throughout the entire period from March, 1934 to October, 1937, except that the Debtor's net operating income kept declining and its financial condition kept getting worse.

The Circuit Court of Appeals referred to its earlier decisions in *Kolkman* v. *Manufacturers Trust Co.*, 27 Fed. (2d) 659; and *Matters* v. *Manufacturers Trust Co.*, 54 Fed. (2d) 1010, both cited with approval many times, in the latter of which it had held that "a deposit made in ordinary course of business, over which the depositor means to keep full control, is not a preferential transfer," and that "in a case like this, the bank must understand that the account is being built up so as to be available at the proper time for seizure," and that "the deposit becomes a transfer because the depositor means it to be such; that is, he means not to exercise his right of withdrawal as to all of it, but to leave some part until that right is gone." But, apparently for the reasons above stated, it departed from these decisions and also failed to apply the qualifications upon a banker's right of set off laid down by this court in the *Massey* case.

Here, the Debtor did not mean to keep full control over its deposits; it had given up that right when it agreed that no moneys could be withdrawn except with the consent of the Banks. Here, also, the Banks understood during the entire three year period that the accounts were being built up so as to be available at the proper time for seizure (i. e. whenever they decided to seize).

That deposits not made in the ordinary course of business but made for the purpose of creating a fund which the bank may seize and set off against the depositor's note whenever it desires to do so are not such deposits as may

be set off under the rule of the *Massey* case has also been recognized in other Circuits. See

Frankford Trust Co. v. *Comber,* 68 Fed. (2d) 471 (C. C. A. 3), affirming 5 Fed. Supp. 659;
Citizen's National Bank of Gastonia, N. C. v. *Lineberger,* 45 Fed. (2d) 522, 529 (C. C. A. 4);
In re Almond-Jones Co., 13 Fed. (2d) 152, 156, affirmed *sub nomine Union Trust Co.* v. *Peck,* 16 Fed. (2d) 986 (C. C. A. 4);
German-American State Bank v. *Larimer,* 235 Fed. 501 (C. C. A. 8).

In *Kentucky Rock Asphalt Co.* v. *Helburn,* 108 Fed. (2d) 779, 781 (C. C. A. 6) the court said, citing the *Massey* case,

> "In general, it is the deposit of money in a bank, with the right to withdraw it, which constitutes the relationship of debtor and creditor between the bank and the depositor. If the money is * * * deposited under circumstances which give the depositor no right to control it, the relationship does not exist."

The District Court held that the evidence did not justify a finding of intent to prefer the Banks at the times when the deposits were made or on October 19th, 1937, because the deposits were not made in contemplation of winding up as an impending fact and the Debtor was continuing to manage and operate its apartment house with every hope and intention of being able to make a satisfactory adjustment with respect to interest and amortization on its first mortgage, when that mortgage became due (R. 31). But the mortgage had fallen due on October 1st and it had failed in making any adjustment.

In Re Almond-Jones Co., Inc., 13 Fed. (2d) 152, 157 the court said that it was possible that new capital might be obtained and a compromise made with creditors and the bank make a new loan, restoring the funds withdrawn, but, in the meantime, the deposits were made, not in the belief

that the bankrupt might withdraw them at will, but with the expectation that the bank would set them off, and the setoff was disallowed and affirmed on appeal (16 Fed. (2d) 986).

Argument as to Second Causes of Action.

Debtor had failed to pay its obligations, when due.

On October 19, 1937 the interest on the first mortgage had fallen due and was never paid. The District Court held (R. 26, 31-32) that this did not constitute a refusal to pay an obligation, when due, because the Debtor had until October 20th to pay the interest before being in default, citing *Barker* v. *472 Fulton Street Corporation,* 24 N. Y. Supp. (2d) 570, in support. This case held that a corporation had not failed to meet its obligation to pay rental under a lease on the first of each month, because it had always paid on the 10th or 12th. It was, however, modified on both the law and the facts in 262 App. Div. 892, and recovery of the alleged preferential payment directed.

It was argued below that because the mortgage contained a clause providing that the principal should become due, at the option of the mortgagee, if default for twenty days in payment of interest occurred (Ex. 3, R. 177), interest was timely paid, if paid at any time during such period, and that the mortgagee had acquiesced in such arrangement. But such clauses only accelerate the principal. They do not extend the due date of the interest, for the mortgagee could have brought suit on October 2d to collect the interest. *Malcolm* v. *Allen,* 49 N. Y. 448.

Nor can acceptance of interest after the due date operate to extend the due date in the future, especially where, as here, the mortgage provides that failure to insist upon strict performance shall not be construed as a waiver or relinquishment for the future of any covenant (Ex. 3, R. 181).

The Circuit Court of Appeals did not pass on this question, although it remarked that there was much to be said

in support of the position that custom had sanctioned the payment of interest at any time up to the twentieth day of the month (R. 366-367).

The Banks were Stockholders of the Debtor

On October 19, 1937, all the capital stock of the Debtor, with the exception of four shares in the names of the four directors, had been transferred to, and stood on its books in the names of, C. A. England & Co. and Tag & Co., nominees of the Banks (R. 327-328, Ex. 15, R. 919-921).

The District Court did not consider this question but the Circuit Court of Appeals held (R. 366) that the Banks were not really stockholders but creditors and that to call them stockholders would destroy a security device, viz. tying up the voting stock, which §15 was really not designed to hit.

But the reason for the enactment of §15 must have been to prevent those in actual control of a corporation, whether stockholders, directors or officers, from transgressing the well settled rule of equity prohibiting such persons from taking advantage of their knowledge and position by appropriating to themselves the assets of the corporation to the exclusion of other creditors. If that was the purpose, then whether the Banks held the stock as security, merely for voting purposes, i. e. control, or as absolute owners for a valuable consideration, is immaterial. The Banks, by having all the Debtor's capital stock transferred to their nominees, by having two of their nominees elected to its board, limited to four directors, thus acquiring practical control thereof, and by requiring that all checks on the Debtor's bank accounts must be countersigned by one of these two directors, in practical effert constituted themselves the corporation. They became its real owners, even though it be presumed, as the Circuit Court of Appeals did, that they had no desire to become owners.

There is no reported case, State or Federal, in which the meaning of the term "stockholders" in the first sen-

tence of §15 or its applicability to such a situation as is here presented has been considered. But we fail to see why persons to whom stock has been transferred on the books of the corporation, whether as collateral, as part of it clearly was (R. 207, Ex. A, R. 1060-1071, Ex. 20, R. 1008), or only to insure voting control, as some might have been (R. 322-324, Ex. B, R. 1072-1074), should not be considered as stockholders under this statute, as they have been under other statutes.

When stock pledged as collateral is transferred into the name of the pledgee, the pledgee becomes a stockholder and liable under a statute holding stockholders liable for the debts of the corporation.

Rosevelt v. *Brown,* 11 N. Y. 148;
Van Tuyl v. *Robin,* 160 App. Div. 41, affirmed in 211 N. Y. 540.

And also liable for assessments under the National Banking Act.

National Bank v. *Case,* 99 U. S. 628.

Such transferees have all the rights of stockholders.

Poole v. *West Point Butter & Cheese Association,* 30 Fed. 513, 518.

A stockholder is one who appears on the corporate books as owner and, therefore, entitled to a voice in its management.

Lee v. *Riefler & Sons, Inc.,* 43 Fed. (2d) 364.

CONCLUSION

The petition should be granted

Addison S. Pratt,
Petitioner in Person.

22

FILED
DEC 16 1942
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term—1942.

No. 542

ADDISON S. PRATT, as Trustee of JACELLEN REALTY CORPORATION, Debtor,
Petitioner, (Plaintiff below),

AGAINST

CHEMICAL BANK & TRUST COMPANY and THE CONTINENTAL BANK AND TRUST COMPANY OF NEW YORK,
Respondents, (Defendants below).

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

WILZIN & HALPERIN,
Counsel for Respondents,
No. 1270 Sixth Avenue,
New York City.

MICHAEL HALPERIN,
Of Counsel.

LODER APPEAL PRESS, INC., 65-67 Duane St., N. Y. C., Tel. WOrth-2-0689

INDEX.

	PAGE
Opinions Below	1
Statement and Matter Involved	1
Facts	3
Respondents' Contention	4
The Proof Did Not Support the Plaintiff-Appellant's Cause of Action	5
Debtor Was Not Insolvent or Imminently Insolvent in October, 1937	6
The Debtor Transferred No Property in October, 1937, Intended No Preference and Created No Preference; the Respondents Had No Cause to Believe a Preference Could Exist	6
No Aggrieved Creditors	6
Conclusion	8

AUTHORITIES CITED.

	PAGE
Section 223, New York Real Property Law	4
Sullivan v. Rosson, 223 N. Y. 217	4
Van Rennsalaer v. Dennison, 35 N. Y. 393	4
Williams v. Ingersoll, 89 N. Y. 508	4
Lynch v. Conger, 168 N. Y. S. 856	4
Holmes v. Evans, 192 N. Y. 140	4
Fairbanks v. Sargent, 117 N. Y. 329	4
Crosby v. Packer, 22 F. (2) 611	4
Mills v. Virginia Carolina Lumber Co., 164 F. 168	4
Scott v. Armstrong, 146 U. S. 499	4
129 Fed. (2) 1016	2
Merriam v. Wimpheimer, 25 Fed. Sup. 405	6
Irving Trust Company v. Metro Goldwyn Mayer, 246 App. Div. 1	6
Todarelli v. Visigraph, 34 Fed. (Supp.) 762	6
Corney v. Salzman, 22 F. (2) 268	7
Prudence Co. Inc., 16 F. Supp. 282	7
New York State Civil Practice Act, Section 1077, Sections A and B	8
Emerson v. Berman, 57 Fed. (2) 637	8

Supreme Court of the United States

OCTOBER TERM—1942.

No. .....

ADDISON S. PRATT, as Trustee of JACELLEN REALTY CORPORATION, Debtor,
Petitioner, (Plaintiff below),

AGAINST

CHEMICAL BANK & TRUST COMPANY and THE CONTINENTAL BANK AND TRUST COMPANY OF NEW YORK,
Respondents, (Defendants below).

Brief for Respondents, in Opposition to Petition for Writ of Certiorari to Review the Judgment of the United States Circuit Court of Appeals for the Second Circuit.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States.

Chemical Bank & Trust Company and The Continental Bank and Trust Company of New York, respondents, respectfully pray that the petition for the issuance for a write of certiorari to review the judgment of the United States Circuit Court of Appeals for the Second Circuit be denied, for the reason that no error was made by the

District Court or by the Circuit Court of Appeals for the Second Circuit in their unanimous affirmance of the judgment of the District Court; for the reason that no question of general public interest is involved; for the reason that the determination does not have any unusual significance or importance in the administration of the bankruptcy act; for the reason that the decision of the Circuit Court of Appeals and the District Court is in conformity with the adjudicated cases of this Court and does not present any novel question of law and involves no interpretation of any Federal Statute, nor does the judgment in the within captioned matter in any manner conflict with the adjudications in this Court or the Courts of the State of New York on the interpretations given to Section 15 of the New York Stock Corporation Law. No statutes affecting the war effort are involved.

Opinions Below.

The opinion of the District Court dismissing the complaint on the merits after a trial, has not been officially reported. The opinion of the Circuit Court of Appeals reported in 129 Fed. (2d) 1016 unanimously affirmed the judgment of the District Court.

Statement of Matter Involved.

The proceedings for the reorganization of the Jacellen Realty Corporation under Section 77B of the Bankruptcy Act were filed for the purposes of promulgating a plan which would contemplate an extension of a first mortgage on the property owned by the corporation and provide for a reduction in the rate of interest payable. The Debtor was unable to obtain the necessary consents to the Debtor's Plan of Reorganization, resulting in the Realty Associates promulgating its Creditor Plan and acquiring the real property, having a substantial value in excess of the first mortgage and all other obligations of the Debtor.

Notwithstanding that all creditors, except the respondent banks, were paid in full, the within action was instituted. The Trustee relied upon an alleged violation of Section 15 of the New York Stock Corporation Law. The evidence however established that *not one* of the six necessary essentials to establish a cause of action under Section 15 of the Stock Corporation Law existed. The District Court held that the Debtor was not insolvent or imminently insolvent in October, 1937, and had not refused to pay its obligations in the regular course of business. The Circuit Court of Appeals affirmed the conclusions reached by the District Judge and further found that the contract between the Debtor and the respondents accomplished, and was equivalent to, an assignment of rents. The money retained by the banks in October, 1937, was not property of the Debtor but the bank's collateral.

Facts.

The Jacellen Realty Corporation, the Debtor, did not engage in general commercial business. The corporation was formed to own and operate one building in the City of New York. Its sole asset was the real property and the rents derived therefrom. Its sole liabilities were the operating charges and the cost of the building construction.

The construction of the building had been completed in 1932 but in 1934 there still remained approximately $175,000 due to sub-contractors. To secure this indebtedness, the rents of the property had been assigned to the sub-contractors. In March, 1934, the contractors offered to take $55,000 in discharge of their $175,000 indebtedness and offered to release their assignment of rents as part of the transaction. The Debtor was unable to pay interest on its first mortgage, and taxes on its real property due to its pledge of the rents to the contractors. An ap-

plication was made to the respondent banks, for a loan in the sum of $54,000 to complete the purchase. The respondents were willing to lend the money *but only on the basis of full and complete security being given to them. They required and received in March, 1934, a pledge of all of the rents and income of the real property as collateral.* They required the designation of their agent to collect the rents and deliver same to them. The respondents then held the rents (for bookkeeping purposes) in an account in the Debtor's name, but subject solely to the control of the respective respondents. The loans were evidenced by collateral demand notes containing the usual provisions giving the respondents liens on all cash or funds in the banks' possession. By the laws of the State of New York, said contract and transaction constituted an equitable assignment of the rents. Section 223, New York Real Property Law: *Sullivan* v. *Rosson,* 223 N. Y. 217; *Van Rennsalaer* v. *Dennison,* 35 N. Y. 393; *Williams* v. *Ingersoll,* 89 N. Y. 508; *Lynch* v. *Conger,* 168 N. Y. S. 856; *Holmes* v. *Evans,* 192 N. Y. 140; *Fairbanks* v. *Sargent,* 117 N. Y. 329; *Crosby* v. *Packer,* 22 F. (2) 611; *Mills* v. *Virginia Carolina Lumber Co.,* 164 F. 168; *Scott* v. *Armstrong,* 146 U. S. 499.

Thus Section 15 of the Stock Corporation Law Act, has no application.

Respondents' Contention.

It is the position of the respondents, that the moneys credited to the loans in October, 1937, were not free funds of Jacellen Realty Corporation, but the Banks' collateral pledged concurrently with the making of the loan. Nothing was transferred from the Debtor in October, 1937, within the purview of Section 15 of the Stock Corporation Law. None of the essentials for a cause of action under Section 15 existed. Jacellen was not insolvent in October,

1937, nor imminently insolvent, but on the contrary, had an equity in its real property in excess of three hundred thousand ($300,000) dollars. Jacellen had no general creditors, in October, 1937, other than the respondents. The corporation conducted its business in the usual course in October, 1937, and paid its obligations when due. The capital stock of Jacellen Realty Corporation was not owned by the respondents, but was merely escrowed or pledged to assure compliance with the contract made in March, 1934, between the respondents and the corporation. The respondents were not preferred, but on the contrary, all creditors except the respondents, received payment in full, and there is still an unpaid balance of indebtedness to them of upwards of $32,000.

The Proof Did Not Support the Plaintiff-Appellant's Cause of Action.

The complaint is based upon a violation of Section 15 of the Stock Corporation Law. Six necessary elements must exist for a recovery by the plaintiff. If any one is lacking, the cause of action must fall. The proof conclusively established that *none* of the essentials existed. The six essentials under Section 15 are as follows:

1. Insolvency or imminent insolvency of the Bankrupt (Debtor).
2. A transfer while insolvent.
3. That the Transferee knew or had reasonable cause to believe that a preference would result.
4. That the Bankrupt (Debtor) intended to give a preference.
5. That there were creditors preferred against by the giving of the transfer.

6. That Debtor-owned property was transferred in October, 1937.

Debtor Was Not Insolvent or Imminently Insolvent in October, 1937.

The uncontradicted testimony established that on the date of the alleged transfer, the corporation had assets in excess of $2,037,827.65 with maximum liabilities not in excess of $1,650,000 (fols. 223-4). The corporation made a profit in every year of its operations (fols. 448-49). It had made principal payments from profits in excess of $105,000.00. The Debtor's profits in 1936 were greater than 1935 and likewise in 1937 its profits were greater than in 1936. Its profits in 1938 in *receivership* were greater than in 1937 (fols. 229-30, 451).

The Debtor Transferred No Property in October, 1937, Intended and Created No Preference; the Respondents Had No Cause to Believe a Preference Could Exist.

The lack of these essentials is adequately discussed in the opinions of both the District Judge and of Judge Clark for the Circuit Court. An equitable assignment resulted in 1934 when the contract was made (cases *supra*). No title passed from the Debtor in 1937 to the funds received by the bank directly from the rents pledged. *Merriam* v. *Wimpheimer,* 25 Fed. Sup. 405; *Irving Trust Company* v. *Metro Goldwyn Mayer,* 246 A. D. 1; *Todarelli* v. *Visigraph,* 34 Fed. (Sup.) 762.

No Aggrieved Creditors.

Neither the District Court nor the Circuit Court, found it necessary to ascertain whether or not there were any aggrieved creditors. Actually there were no aggrieved

creditors. The agreed facts (fol. 991) established that the only possible creditors of the Debtor were as follows:

1. Aeson Corporation
2. General creditors (current bills)
3. Certificate holders (first mortgage issue)
4. Realty Associates (Junior participation in first mortgage)
5. The respondent banks.

Aeson's claim was subordinated to the banks' and was treated as part of the banks' claim (fol. 208). General creditors were fully paid and discharged before the filing of the petition by the Debtor (fols. 221-25). Certificate holders received new certificates for the full amount of their claim together with interest at 5%. The certificate holders were fully secured creditors and not entitled to share in the general assets. Section 57 h, U. S. Bankruptcy Act. Realty Associates received the equity in the property and retained their Junior interest as a second mortgage (fol. 879). Realty Associates was a secured creditor in the full amount of its claim. The fair value of the property, acquired by it was in October, 1937, in excess of the full claim of the Realty Associates (fols. 354-233-4-228). By elimination, the only creditors were the respondents and therefore there were no creditors who could have been preferred against.

The petitioner's arguments on its second cause of action which also is based upon Section 15 of the Stock Corporation Law are fully refuted in the opinion rendered by the Circuit Court in unanimously affirming the dismissal of the complaint by the District Judge. *Corney*

v. *Salzman*, 22 F. (2) 268; *Prudence Co. Inc.*, 16 F. Supp. 282; New York State Civil Practice Act, Section 1077, Sections A and B; *Emerson* v. *Berman*, 57 Fed. (2) 637.

Conclusion.

The petition for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit should be denied.

Respectfully submitted,

MICHAEL HALPERIN,
Attorney for Respondents,
(Defendants below).